

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

THE CHANCELLOR'S OFFICE OF THE
CALIFORNIA COMMUNITY COLLEGES HAS DEVELOPED
PROCEDURES THAT RESULT IN A CIRCUMVENTION
OF MANY STATE FISCAL CONTROLS

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OFFICE OF THE AUDITOR GENERAL

P-768

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May 10, 1989

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Honorable Elihu M. Harris, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 2148
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report showing that the Chancellor's Office used a variety of methods to bypass the State's controls over receipts, expenditures, and hiring.

Respectfully submitted,

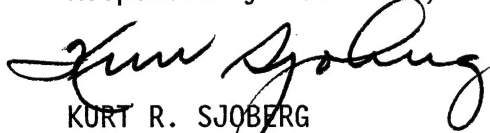

KURT R. SJOBERG
Acting Auditor General

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SUMMARY

RESULTS IN BRIEF

The Chancellor's Office of the California Community Colleges (Chancellor's Office) used a variety of methods to bypass the State's controls over receipts, expenditures, and hiring. The following conditions resulted from bypassing the State's controls:

- An employee of the Chancellor's Office unilaterally instructed three community college districts, which acted as fiscal agents on behalf of the Chancellor's Office, to make over \$821,000 in payments to a consulting firm that allegedly provided no services;
- The Chancellor's Office used the Los Rios Foundation as its fiscal agent to collect and disburse over \$124,000 in registration fees from conferences sponsored by the Chancellor's Office;
- The Chancellor's Office improperly awarded at least 13 consultant contracts worth over \$940,000 to the Community College Foundation;
- The Chancellor's Office directed its fiscal agents to use a portion of the \$7.3 million in local assistance funds appropriated to one of its programs to pay administrative expenses normally paid from a state department's support budget;
- The Chancellor's Office sometimes circumvented the civil service system by improperly contracting for services; and
- The Chancellor's Office allowed certain employees to have unilateral discretion over allocations of certain program funds and failed to exert proper supervision.

BACKGROUND

The Chancellor's Office is the administrative arm of the Board of Governors of the California Community Colleges, serving primarily as a planning, reporting, advising, and regulating agency for the 70 community college districts. The Legislature appropriates funds to the Board of Governors for the support of the Chancellor's Office and for local assistance activities such as educational programs at community college districts. In the 1987-88 Final Budget Summary, the Legislature appropriated over \$1.37 billion in support and local assistance funds for the community college system, \$85.9 million of which was earmarked for student services. Student services programs, which are intended to serve "the needs of the economically, culturally, or physically disadvantaged students," are administered through the Student Services and Special Programs unit of the Chancellor's Office.

In October 1983, the Board of Governors established the Community College Foundation to assist and promote the educational activities of the Board of Governors on behalf of the community colleges. The foundation's revenues initially came, for the most part, from minor fund-raising activities; however, since October 1986, it has received almost all of its revenues through contracts and grants from governmental entities.

PRINCIPAL FINDINGS

The Chancellor's Office of the
California Community Colleges
Channeled Funds Outside the
State's Fiscal Controls

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office directed five community college districts to spend, on behalf of the Chancellor's Office, over \$9 million in

funds designated for three student services programs. Because the districts are not subject to the State's fiscal controls, these expenditures, which included payments for consulting services, travel expenses, and equipment, were made without adequate controls and sometimes for inappropriate purposes. For example, the former acting dean of Special Services instructed three of these districts to pay \$821,000 to a consulting firm that allegedly provided no services.

In addition, the Chancellor's Office used the Los Rios Foundation to collect \$124,000 in registration fees from conferences sponsored by the Chancellor's Office. It then directed the Los Rios Foundation to spend \$11,000 of those fees, outside state controls, for purchases the Chancellor's Office could not make itself.

The Chancellor's Office's Use of
the Community College Foundation
Circumvents the State's Fiscal Controls

State agencies are generally required by law to seek competitive bids on the contracts they award. The Chancellor's Office misinterpreted an exemption from competitive bidding on service contracts awarded to the Community College Foundation (foundation), applying the exemption to its consultant contracts with the foundation. Specifically, from November 1986 through January 1989, the Chancellor's Office improperly awarded at least 13 consultant contracts worth over \$940,000 to the foundation without seeking competitive bids. Furthermore, this exemption on service contracts allows the Chancellor's Office and other state agencies to legally avoid the State's competitive bidding requirements on service contracts and to direct the foundation to hire the contractors of their choice. Finally, using profits generated from its contracts with the Chancellor's Office and other state agencies, the foundation makes expenditures on behalf of the Chancellor's Office that the Chancellor's Office itself could not legally fund.

Local Assistance Funds Were Used
To Pay Some Administrative Costs
of the Chancellor's Office

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office directed its fiscal agents to use \$7.3 million in local assistance funds appropriated to Disabled Student Programs and Services to pay administrative expenses normally paid from a state department's support budget. The budget act does not clearly define the purpose or limit the amount of local assistance funds the Chancellor's Office may use for its own administration and for special projects benefiting the districts. Further, the use of these funds for administrative expenses at the Chancellor's Office has increased approximately 350 percent over the last five fiscal years while funding for all Disabled Student Programs and Services has increased only 29 percent during the same period.

The Chancellor's Office's Use of
Contract Employees Sometimes Circumvents
The State's Civil Service System

The Chancellor's Office is circumventing the State's civil service system by improperly contracting for services in some instances rather than hiring civil service employees. Of the 88 contract employees who worked at the Chancellor's Office during the period from September 1986 through December 1988, the Chancellor's Office could cite no legal hiring authority for 48. Moreover, the State Personnel Board, which reviewed the contracts for 7 of the 48 employees, concluded that the Chancellor's Office improperly entered into contracts with these 7 employees. By contracting for services improperly rather than hiring employees through the civil service system, the Chancellor's Office denies individuals who have passed the State's civil service examinations the opportunity to compete for those positions.

Based on information provided by the Chancellor's Office, as of April 25, 1989, the Chancellor's Office had converted 20 of the positions formerly held by these 48 contract employees to civil service positions, while 8 of these employees were still working under contract for the Chancellor's Office.

Employees of the Chancellor's Office
Have Had Too Much Discretion Over
Allocating Certain Program Funds

The employees of the Chancellor's Office who have been responsible for allocating funds to the community college districts for some student services and special programs have had unilateral discretion over those allocations and have not been properly supervised. For example, the former acting dean of Special Services, who had responsibility for the redistribution of unexpended Disabled Student Programs and Services funds, redirected \$329,000 of these funds outside state controls to supplement the amount available for expenditures made on behalf of the Chancellor's Office. In addition, other programs of the Chancellor's Office lack systematic methods or do not always follow their procedures for allocating funds. Thus, the Chancellor's Office cannot ensure that the allocation process is uniform and objective.

RECOMMENDATIONS

To ensure the appropriate use of the State's funds, the Chancellor's Office of the California Community Colleges should take the following actions:

- Discontinue using fiscal agents to make payments;
- Obtain reimbursement from the consulting firm that was paid but allegedly provided no services;

- Collect its conference registration fees itself and deposit those fees in the state treasury system;
- Stop improperly awarding consultant contracts to the Community College Foundation; and
- Limit contract-related fees paid to the foundation to actual administrative costs.

To ensure that state funds are used as intended, the Legislature should consider taking the following actions:

- Clarify the purpose and limit the amount of local assistance funds used by the Chancellor's Office for its own administration and for special projects benefiting the districts; and
- Reconsider the Community College Foundation's exemption from competitive bidding requirements for service contracts to determine if the exemption is appropriate.

To ensure that the Chancellor's Office adheres to all applicable civil service standards, the legal counsel for the Chancellor's Office should review all contract proposals as required by its contracts manual.

To ensure that the funds for the programs it administers are properly allocated to the districts, the Chancellor's Office should establish a written, systematic method for allocating the funds used on its behalf and for redistributing unexpended funds from districts' college programs.

AGENCY COMMENTS

The chancellor of the California Community Colleges responded that his office is in the process of addressing some of the recommendations in our report. The chancellor also indicated that he felt that our findings are primarily confined to specific lapses in management and fiscal processes that allowed the alleged embezzlement to occur. Further, the chancellor stated that most of our findings relate to an employee of the Chancellor's Office who was arrested and to procedures that the employee monitored or established. Finally, the chancellor was concerned that our findings reflect on the entire agency when, in his view, they only involve the management and supervision of specific and isolated situations.

INTRODUCTION

The Chancellor's Office of the California Community Colleges (Chancellor's Office) is the administrative arm of the Board of Governors of the California Community Colleges and serves primarily as a planning, reporting, advising, and regulating agency for the seventy California community college districts.

The chancellor of the California Community Colleges is appointed by the Board of Governors. Four chancellors, including one interim chancellor, have served at the pleasure of the Board of Governors since 1980, including the current chancellor, who was appointed July 1, 1988. (See Appendix A for the names and terms of the chancellors since 1980.)

The Legislature appropriates funds to the Board of Governors for the support of the Chancellor's Office and for local assistance activities such as educational programs at community college districts. In the 1987-88 Final Budget Summary, the Legislature appropriated over \$1.37 billion in support and local assistance funds for the community college system. Of the \$1.36 billion appropriated for local assistance, \$85.9 million was specifically earmarked for student services.

According to the 1987-88 Governor's Budget, student services include programs intended to serve "the needs of the economically, culturally, or physically disadvantaged students who require assistance to participate more fully in, and benefit from, a college education." Included under the student services umbrella are the Community College Extended Opportunity Programs and Services, Disabled Student Programs and Services, Cooperative Agencies Resources for Education, Transfer Centers, Foster Parent Training, and Matriculation programs. These, as well as other programs, are administered through the Student Services and Special Programs unit of the Chancellor's Office. Funds appropriated to such special programs make up a relatively small percentage of total local assistance dollars. For example, of the \$1.36 billion in local assistance funds appropriated for fiscal year 1987-88, only \$27.8 million--approximately 2 percent--was designated for Disabled Student Programs and Services.

In October 1983, the Board of Governors established the Community College Foundation (foundation). According to its articles of incorporation, the purpose of the foundation is to assist and promote the educational activities of the Board of Governors on behalf of the California Community Colleges. Specifically, the foundation engages in the solicitation of grants and contracts, receives contributions, dispenses the funds received to support the educational programs and general welfare of the community colleges, and assists the colleges in fulfilling their role of service to the citizens of the State.

From its inception in 1983 until the fall of 1986, the foundation's revenues resulted mainly from various minor fund-raising efforts. Beginning in October 1986, the sources of funding for the foundation changed significantly. From October 1986 through December 31, 1988, the foundation received and administered over \$8.1 million, all of it awarded by various governmental entities, through grants and contracts generally intended to benefit the educational programs or general welfare of the community colleges. Four entities, including the Department of Rehabilitation, the Department of Transportation, the Department of Social Services, and the Chancellor's Office, have supplied over 90 percent of the foundation's revenues since 1986.

SCOPE AND METHODOLOGY

The purpose of this audit was twofold: we were initially charged with examining the relationship between the Chancellor's Office and its fiscal agents, including various community college districts and the foundation. We sought to determine whether the Chancellor's Office had used its fiscal agents in ways that bypass the State's civil service system and fiscal controls. On September 26, 1988, agents from the Department of Justice arrested the former acting dean of Special Services, an employee of the Chancellor's Office. He was charged with grand theft of state funds and conflict of interest involving over \$950,000 in payments issued by four community college districts acting as the Chancellor's Office's fiscal agents. Of the \$950,000 in

payments, \$821,000 related to our audit period, fiscal years 1983-84 through 1987-88, and the remaining \$129,000 related to other periods. One of the four fiscal agents made payments prior to fiscal year 1983-84, and thus, its payments are not included in the \$821,000. The payments were issued to a consulting firm that allegedly provided no services. Investigators reported that the fictitious business name of the consulting firm is registered with the Sacramento County Clerk under the names of the former acting dean's wife and mother-in-law. Because of this alleged theft, we expanded the scope of our audit to include a comprehensive review of fiscal activities and internal controls related to the Student Services and Special Programs unit.

To determine if the Chancellor's Office provided the foundation unreimbursed office space, equipment, support services, or supplies, we reviewed the terms of each contract between the foundation and the Chancellor's Office. In addition, we interviewed the executive director of the foundation and Chancellor's Office personnel.

To determine if the foundation is properly established under state laws, we reviewed the relevant laws, rules, regulations, bylaws, and articles of incorporation of the foundation. In addition, we obtained a legal opinion from California's Legislative Counsel.

We reviewed the terms of every contract or grant received by the foundation from October 1986 through December 1988 to determine if the foundation's activities complied with the applicable laws and

regulations and its stated objectives. In addition, we tested a sample of foundation expenditures from the same period to see if they complied with the terms of the corresponding contracts.

We reviewed the foundation's accounting records to document sources and uses of funding from October 1986 through December 1988. We also tested a sample of receipts and expenditures from that period to determine if the transactions were properly recorded in the foundation's accounting records, and we reconciled the cash receipts and expenditures from the foundation's bank accounts with its accounting records for that same period. In addition, we tested a sample of expenditures to determine if the foundation's controls over expenditures are adequate to prevent payments of incorrect amounts, duplicate payments, unauthorized payments, payments for inappropriate purposes, and payments for goods or services not received.

In our review of the following areas, we found few or no weaknesses:

- The foundation is properly established as a nonprofit, public-benefit corporation formed pursuant to Part 2 (beginning with Section 5110) of Division 2 of Title 1 of the Corporations Code;

- The foundation's Board of Directors is properly constituted. An amendment to the foundation's bylaws, dated January 26, 1988, removed the chancellor and president of the Board of Governors from their positions as directors of the foundation; and
- Our limited review of the foundation's accounting records did not disclose any material weaknesses. Further, the financial audit for fiscal year 1987-88, performed by the accounting firm Price Waterhouse, did not disclose any material weaknesses in the foundation's internal control system.

Under the expanded scope of this audit we were to determine whether specific policies and procedures have been effective in protecting the assets of the Chancellor's Office. We focused our review on local assistance funds appropriated to Disabled Student Programs and Services (DSPS), Extended Opportunity Programs and Services (EOPS), and Cooperative Agencies Resources for Education (CARE) during fiscal year 1983-84 through fiscal year 1987-88. We tested DSPS funds extensively because the alleged theft by the former acting dean of Special Services involved these funds exclusively.

We reviewed the activities of community college districts acting as fiscal agents on behalf of the Chancellor's Office and determined the amount of funds allocated to those districts from fiscal year 1983-84 through fiscal year 1987-88 for the DSPS, EOPS, and CARE

programs. From those funds, we determined the amounts allocated for the districts' own programs and the amounts allocated to the districts to be spent on goods or services received by the Chancellor's Office.

At the five districts acting as fiscal agents for the Chancellor's Office, we tested over \$5,134,000 of the expenditures from fiscal year 1983-84 through fiscal year 1987-88 for consulting services and approximately \$727,700 in equipment expenditures for the same period. In addition, we tested \$84,500 in travel reimbursements made by two of the five districts during fiscal years 1986-87 and 1987-88. We also determined the total amount of consulting services and equipment purchased for the Chancellor's Office by its fiscal agents during the five fiscal years we reviewed. Finally, we reviewed the fees charged by those districts for their fiscal agent services.

As a result of our review of expenditures made by the fiscal agents, we discovered that the Chancellor's Office was directing conference registrants to send their registration fees to the Los Rios Foundation, which then deposited these fees in its bank account outside of the state treasury system. We determined if the Chancellor's Office's use of an account outside of the state treasury system was proper. We also reviewed the expenditures related to the Chancellor's Office's conferences during 1987 and 1988 to determine if those expenditures complied with state regulations.

To determine if the Chancellor's Office allocated or awarded funds using preferential treatment, we reviewed special programs funded by the Chancellor's Office, examining each program's policies and procedures for allocating funds and awarding contracts. We tested certain allocations for fiscal year 1987-88, and we reviewed records at the Chancellor's Office to determine if contracts were properly completed. Finally, we obtained a Legislative Counsel opinion on the awarding of contracts to the Community College Foundation.

To determine if the Chancellor's Office monitors the expenditure of program funds adequately, we reviewed a sample of payments to ascertain whether they were properly authorized, were for the correct amounts, were for appropriate purposes, and were paid only once.

To determine if the Chancellor's Office used fiscal agents to circumvent the State's civil service system, we obtained a list of individuals who were not civil service employees but who worked for the Chancellor's Office at its headquarters at any time from September 1986 through December 1988. We asked the Chancellor's Office to cite the authority allowing it to hire contract employees instead of civil service employees. We then reviewed duty statements, contracts, or other information provided by the Chancellor's Office to determine whether the Chancellor's Office had properly hired its contract employees. We also analyzed requests made by the Chancellor's Office for budget changes in fiscal years 1985-86 and 1986-87 to determine

whether the Chancellor's Office had tried to obtain funding for additional personnel through its support budget.

Finally, we cooperated with the Department of Justice in its investigation of alleged criminal activities at the Chancellor's Office. Section 10520 of the California Government Code requires the Office of the Auditor General to conduct audits in accordance with the "Government Auditing Standards" by the comptroller general of the United States.¹ These standards require the auditors to notify the top official of the audited entity when the auditors become aware of abuse or illegal acts or indications of such acts.

We offered the Chancellor's Office and the Community College Foundation the opportunity to respond in writing to the draft of this report. The foundation did not choose to respond. In addition to considering written comments from the Chancellor's Office, we discussed the draft report with officials of other agencies mentioned in this report. In preparing the final report, we also considered their comments.

¹This was formerly titled "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

AUDIT RESULTS

I

THE CHANCELLOR'S OFFICE OF THE CALIFORNIA COMMUNITY COLLEGES CHANNELED FUNDS OUTSIDE THE STATE'S FISCAL CONTROLS

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office of the California Community Colleges (Chancellor's Office) used five community college districts to act as its fiscal agents in disbursing over \$9 million in funds related to the Disabled Student Programs and Services (approximately \$7.3 million), Extended Opportunity Programs and Services (approximately \$1.5 million), and Cooperative Agencies Resources for Education programs (approximately \$200,000), which it administers. The community college districts acted as fiscal agents, using the funds to make payments as instructed by the Chancellor's Office for consulting services, travel expenses, equipment purchases, and other items that benefited the Chancellor's Office or enabled the Chancellor's Office to conduct special projects for the colleges. The minutes of meetings of the Board of Governors of the California Community Colleges from October 1974 through December 1988 do not address the Chancellor's Office's use of fiscal agents. However, the president of the Board of Governors stated that he believes fiscal agents are used by the Chancellor's Office as a way to do things more quickly and easily. Expenditures made through fiscal agents were not processed by the State Controller's Office or subjected to other state fiscal controls over expenditures. As a result,

numerous expenditures of state funds were made without adequate controls or for inappropriate purposes. For example, the former acting dean of Special Services was able to instruct fiscal agents to pay \$821,000 to a consulting firm that allegedly provided no services. In other instances, employees of the Chancellor's Office did not properly review travel claims before instructing fiscal agents to pay for travel expenses when no state business was conducted, nor did they obtain competitive price quotations before instructing the fiscal agents to purchase equipment costing over \$439,000.

In addition to channeling funds to the community college districts and specifying their use outside state controls, the Chancellor's Office directed \$124,000 in conference registration fees to the Los Rios Foundation. It then used this foundation to spend over \$11,000 of those fees for items such as alcoholic beverages and other refreshments. According to the State Controller's Office, the Chancellor's Office does not have any authority to make such expenditures. However, the Chancellor's Office was able to circumvent the State's controls that would preclude payment for these purchases by using the Los Rios Foundation, which is not subject to these controls, as a fiscal agent to receive conference registration fees and then make payments at the direction of the Chancellor's Office.

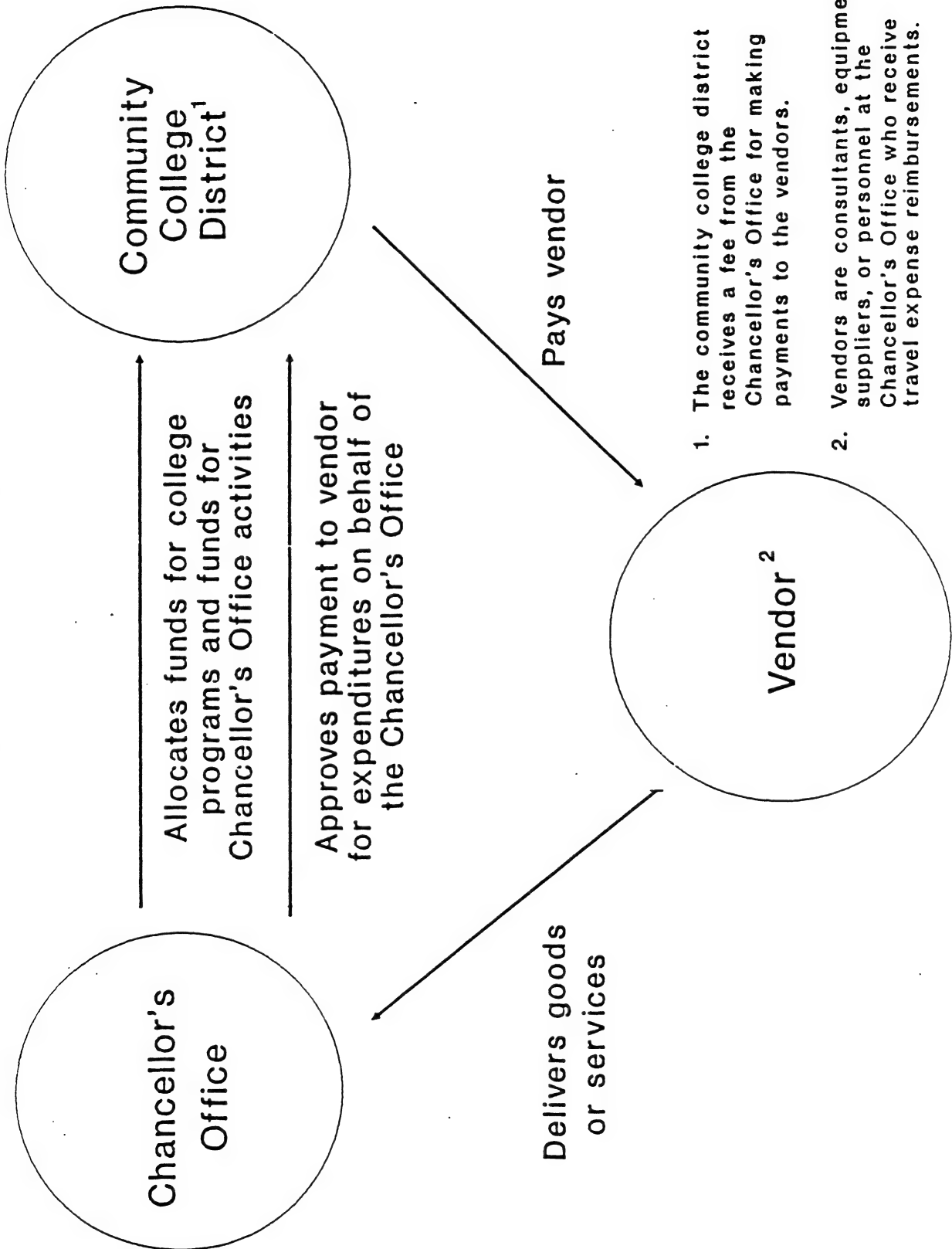
Finally, we identified additional weaknesses in the internal controls of other programs administered by the Chancellor's Office, which are discussed in Appendix D of this report.

THE CHANCELLOR'S OFFICE AVOIDED
STATE CONTROLS BY DIRECTING
EXPENDITURES THROUGH FISCAL AGENTS

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office directed five community college districts to spend over \$9 million on behalf of the Chancellor's Office for the Disabled Student Programs and Services, Extended Opportunity Programs and Services, and Cooperative Agencies Resources for Education programs that it administers. These expenditures were in addition to program expenditures of approximately \$37.4 million that these districts made when they were not acting as fiscal agents for the Chancellor's Office. Rather than processing these nonprogram expenditures through normal state channels, the Chancellor's Office directed the five districts to pay various vendors in exchange for over \$700,000 in administrative fees averaging almost 8 percent of the total payments. Chart 1 depicts the relationship between the Chancellor's Office and its fiscal agents. Appendix B displays the types of expenditures made by these five districts in their role as fiscal agents for the Chancellor's Office.

CHART 1

RELATIONSHIP BETWEEN THE
CHANCELLOR'S OFFICE
AND ITS FISCAL AGENTS



Although the program expenditures of \$37.4 million were subject to the community college districts' fiscal controls, \$9 million in expenditures made at the direction of the Chancellor's Office were not subject to community college fiscal controls and were not subjected to state fiscal controls over expenditures nor processed by the State Controller's Office. Such controls would include, but not necessarily be limited to, the contract approval process and competitive bidding requirements specified in the Public Contract Code, as well as the California Government Code requirements concerning the use of facsimile signatures to authorize payments.

According to the president of the Board of Governors, fiscal agents are used to do things more quickly and easily. However, by using the districts as fiscal agents, the Chancellor's Office avoided review by the State Controller's Office and the other fiscal and contracting controls it must follow when processing payments through its own accounting office. As a result, expenditures made through its fiscal agents were not always in the State's best interests.

Lack of State Controls Over
Expenditures for Consulting Services

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office instructed its fiscal agents to pay over \$5 million for consulting services that generally benefited the Chancellor's

Office or enabled the Chancellor's Office to conduct special projects for the colleges. The Chancellor's Office seldom used contracts in these cases, but when it did, the Department of General Services did not approve the contracts. Further, the Chancellor's Office did not monitor these payments of state funds or subject them to appropriate state fiscal controls, including review by the State Controller's Office. As a result, an employee, acting unilaterally, directed fiscal agents to make payments for services that allegedly were not provided. Also, fiscal agents made other payments for services on behalf of the Chancellor's Office that, although provided, were not related to the stated purpose of the associated contracts.

State fiscal controls, as included in the Public Contract Code, require obtaining three competitive bids before awarding a consulting services contract. In addition, the California Government Code prescribes that the elements of a satisfactory system of internal accounting control should include a system of authorization and recordkeeping procedures adequate to provide effective accounting control over expenditures. A written contract that is properly approved and effectively monitored would provide the necessary control. The California Government Code also states that a satisfactory system of internal accounting control should include an effective system of internal review. Finally, the California Government Code requires certifying and filing with the Secretary of State's Office all manual signatures for which facsimiles will be used to order payments.

From fiscal year 1983-84 through fiscal year 1987-88, the former acting dean of Special Services, without obtaining competitive bids and without a written contract, instructed three fiscal agents to make payments totaling over \$821,000 to a consulting firm. The former acting dean had responsibility for selecting the consulting firm, which allegedly provided no services. Moreover, according to the Department of Justice, the principal owners of this consulting firm were the former acting dean's wife and mother-in-law.

The former acting dean of Special Services used photocopied approval signatures in 75 of 88 documents directing the fiscal agents to make payments to his relatives' consulting firm. The 13 documents that did contain original approving signatures were signed by the former acting dean and his supervisor. The supervisor of the former acting dean admitted to having signed documents in the past but stated that he had not signed any such documents for several years. Finally, the former acting dean instructed two separate fiscal agents each to pay this same consulting firm for identical services, resulting in duplicate payments of at least \$271,000. On September 26, 1988, the former acting dean of Special Services was arrested and charged with grand theft and conflict of interest.

In addition to the consultant chosen by the former acting dean of Special Services, 267 other consultants who did perform services were hired in a similar manner and paid through fiscal agents, their services totaling over \$4.3 million. The Chancellor's Office did not

have written contracts with 248 of the 267 consultants even though the Chancellor's Office was to have received the consulting services. When the Chancellor's Office does not have written contracts detailing the work to be performed, it cannot be assured that the services for which it pays are fully or satisfactorily rendered. Furthermore, the Chancellor's Office did not effectively monitor payments to these consultants. For example, it sent its fiscal agents 282 documents to approve payments for consulting services totaling more than \$853,000 that contained either photocopied or facsimile signatures, rather than original ones. However, the signatures used had not been filed with the Secretary of State's Office, as required. Finally, two individuals working at the Chancellor's Office approved payments by fiscal agents for consulting services although they did not know whether any services had actually been received.

The Chancellor's Office also paid for services unrelated to the stated purpose of contracts. For example, through its use of a fiscal agent, the Chancellor's Office directed funding of a contract expressly providing for computer-related consulting services. However, according to a memo received from the contractor, the Chancellor's Office used at least five of the contractor's employees for purposes other than those stated in the contract. For instance, one of the employees served as the secretary to the former acting dean of Special Services, while another was the receptionist for Disabled Student Programs and Services.

Lack of State Controls Over Expenditures for Travel

In addition to avoiding the State's controls over expenditures when it directed its fiscal agents to pay for consulting services, the Chancellor's Office circumvented the State's controls over travel expenditures by having its fiscal agents pay for some of these expenditures. From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office instructed its fiscal agents to pay over \$1.1 million for travel expenses intended to benefit the Chancellor's Office or special projects for the colleges. These expenditures were not processed by the State Controller's Office or subjected to the normal controls or rules governing travel expenses. We tested 52 payments totaling over \$84,500 for travel expenses paid by two fiscal agents in fiscal years 1986-87 and 1987-88 and found that 30 payments totaling more than \$5,400 were improper according to state rules. For example, the Chancellor's Office used its fiscal agents to pay \$345 for travel expenses incurred by the former acting dean of Special Services for two days following the completion of his state business. In another example, the Chancellor's Office instructed one of its fiscal agents to pay \$173 for one night's lodging for the former acting dean although the allowable rate under state rules was only \$47 per night. In addition, the Chancellor's Office reimbursed this same individual \$225 for travel expenses and also directed its fiscal agent to pay the hotel for the same \$225 in charges. In all, we identified \$5,400 in inappropriate travel expenditures for various individuals, including

\$1,350 in travel expenses paid when no state business was conducted, over \$3,600 in payments exceeding the amount allowed under Department of Personnel Administration rules, and \$496 in duplicate payments. All of these inappropriate payments were made through fiscal agents at the direction of the Chancellor's Office and outside the normal state controls over expenditures.

Lack of State Controls Over
Expenditures For Equipment

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office instructed its fiscal agents to purchase over \$755,000 in equipment and related items that were intended to benefit the Chancellor's Office or special projects for the colleges. Because these purchases were made by its fiscal agents, they were not processed by the State Controller's Office or subjected to the normal controls over state expenditures for equipment.

For example, state fiscal controls, as outlined by the Department of General Services, require obtaining a minimum of two competitive price quotations for any equipment purchases over \$500. The Chancellor's Office directed its fiscal agents to purchase over \$439,000 in equipment without complying with this requirement. As a result, there is no assurance that these purchases were made in the most economical way.

The State's fiscal controls prescribed by the State Administrative Manual also require tagging equipment purchases, when practical, as state property; recording such purchases in the accounting records; counting all equipment at least once every three years; and reconciling the count with accounting records. However, the Chancellor's Office did not tag as state property \$509,000 worth of equipment that was purchased by its fiscal agents and required tagging. Moreover, the Chancellor's Office did not include in its accounting records any of the items of equipment costing over \$500 that it directed fiscal agents to purchase, for a total expenditure of approximately \$490,000. Finally, the Chancellor's Office, over the past five fiscal years, did not make a complete count of all items of equipment purchased by its fiscal agents.

As a result of not following the State's prescribed accounting controls over equipment, the Chancellor's Office cannot specifically identify equipment worth over \$51,000 that its fiscal agents purchased on behalf of the Chancellor's Office. The vice chancellor of Educational Policy stated that to specifically identify the equipment at this time would require a complete physical inventory so that all equipment purchased through fiscal agents could be segregated from all equipment purchased through the normal state procurement process.

THE CHANCELLOR'S OFFICE AVOIDED
STATE CONTROLS BY USING THE
LOS RIOS FOUNDATION AS A FISCAL AGENT

In addition to channeling money to the community college districts and using them as fiscal agents, the Chancellor's Office channeled money to the Los Rios Foundation, using it as a fiscal agent to purchase items the Chancellor's Office itself could not have purchased under state controls. From fiscal year 1986-87 through fiscal year 1987-88, the Chancellor's Office channeled to the Los Rios Foundation \$124,000 in registration fees from conferences it sponsored. The Chancellor's Office then directed the use of over \$11,000 of those fees for expenditures that the Chancellor's Office itself could not have legally made.

The Disabled Student Programs and Services and Extended Opportunity Programs and Services programs within the Chancellor's Office sponsor conferences to provide technical assistance to the community colleges' staff. The Chancellor's Office sends letters to the community colleges, inviting the staff to attend the conferences. The Chancellor's Office instructs the interested parties, who usually pay their registration fees with community college funds, to make their checks payable to the Los Rios Foundation, which deposits these checks in its bank account outside the State's fiscal controls. The Chancellor's Office then uses the Los Rios Foundation, a nonprofit, public-benefit corporation affiliated with the Los Rios Community College District, as its fiscal agent for collecting and disbursing

these conference registration fees in exchange for 10 percent of all the fees collected. However, the Chancellor's Office generally retains control over how the conference registration fees are spent, authorizing most of the expenditures of the registration fees made by the Los Rios Foundation. Furthermore, staff of the Chancellor's Office do most of the planning, site selecting, scheduling, and speaker and topic selecting.

The State Administrative Manual, Section 8001, requires that all money controlled by a state agency be deposited in the state treasury system, except in certain circumstances that do not apply in this case. Money deposited in the state treasury system is subject to the State's controls over expenditures, which include limiting or prohibiting certain types of expenditures as well as safeguarding the State's assets.

Although the Chancellor's Office generally retained control over how the registration fees were spent, it did not deposit those fees into the state treasury system as required by the State Administrative Manual. Instead, during fiscal years 1986-87 and 1987-88, the Chancellor's Office directed at least \$124,000 of conference registration fees under its control to the Los Rios Foundation, whose bank account is not within the state treasury system. From this money, the Chancellor's Office directed the Los Rios Foundation to purchase \$1,077 worth of alcohol for an Extended Opportunity Programs and Services conference held in May 1988. During

this same conference, the Chancellor's Office directed the Los Rios Foundation to pay \$5,716 for appetizers and bar set-ups. If the Chancellor's Office had followed state procedures and deposited the conference registration fees in the state treasury, it would have had to submit claims for these expenditures to the State Controller's Office for payment. According to the State Controller's Office, legal authority for a state agency to make such expenditures does not exist.

In addition to expenditures made without legal authority, the Chancellor's Office often directed the Los Rios Foundation to pay more for lodging and meals at these conferences than state regulations allow. During three of these conferences, the Chancellor's Office directed the Los Rios Foundation to spend a total of at least \$4,000 more for lodging and meals than state regulations allow. For example, the former acting dean of Special Services stayed in a \$300-a-night suite during a 1987 conference. His six-day stay, including room service, restaurant, and bar charges, cost over \$2,500. These charges alone exceed the State's maximum per diem allowance by over \$1,800.

When the Chancellor's Office uses the Los Rios Foundation as a fiscal agent, it does not ensure that the State's assets are protected by adequate controls. For example, the Chancellor's Office did not have a written contract with the Los Rios Foundation specifying the services to be performed in exchange for the 10 percent administrative fee. Furthermore, the Los Rios Foundation was not required to have written authorization from the Chancellor's Office before disbursing

funds. Consequently, based on only verbal authorization from the Chancellor's Office, the foundation's custodian of the conference fees paid at least \$237 to reimburse the district for the time he spent performing his duties as custodian. This compensation was taken from registration fee revenues in addition to the 10 percent administrative fee the Los Rios Foundation received. Also, based on verbal authorization from the Chancellor's Office, the custodian paid an additional \$162 to his wife for preparing conference literature for mailing.

CONCLUSION

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office of the California Community Colleges used five community college districts to pay over \$9 million of local assistance funds for purchases such as equipment, travel, and consulting services that generally benefited the Chancellor's Office or enabled the Chancellor's Office to conduct special projects for the colleges. In addition, in fiscal years 1986-87 and 1987-88, it channeled to the Los Rios Foundation \$124,000 in registration fees from conferences the Chancellor's Office sponsored. Both the community college districts and the Los Rios Foundation acted as fiscal agents to the Chancellor's Office, allowing the Chancellor's Office to direct the expenditure of these funds. Because the funds were channeled outside the state treasury system, the

expenditures that the Chancellor's Office directed the fiscal agents to make were not processed by the State Controller's Office or otherwise subjected to the normal fiscal controls over state expenditures. As a result, an individual within the Chancellor's Office unilaterally directed payments of \$821,000 to a consulting firm that allegedly provided no services. Furthermore, the Chancellor's Office directed five districts and a foundation, acting as fiscal agents, to pay \$1,350 for travel expenses when no state business was conducted, over \$439,000 for equipment without obtaining any competitive price quotations, and at least \$11,000 of inappropriate expenditures from conference registration fees.

RECOMMENDATIONS

To ensure that expenditures made on behalf of the Chancellor's Office are in compliance with the State's fiscal controls, the Chancellor's Office should take the following actions:

- Discontinue using fiscal agents to make payments and instead make expenditures through its own accounting unit following prescribed state control procedures;
- Obtain reimbursement from the consulting firm that was paid for services it allegedly did not provide;

- Tag as state property all equipment purchased by or on behalf of the Chancellor's Office. In addition, the Chancellor's Office should record such purchases in its accounting records as well as count and reconcile the count with its accounting records at least once every three years; and
- Collect registration fees for conferences itself, and deposit those fees in the state treasury system, spending the funds in accordance with state rules and regulations.

II

THE CHANCELLOR'S OFFICE'S USE OF THE COMMUNITY COLLEGE FOUNDATION CIRCUMVENTS THE STATE'S FISCAL CONTROLS

The Chancellor's Office's use of the Community College Foundation (foundation) allows the Chancellor's Office to circumvent the State's controls over contracting. Although state agencies, including the Chancellor's office, are generally required by law to obtain at least three competitive bids on contracts they award, they are exempted from the competitive bidding requirements on service contracts awarded to the foundation. However, the Chancellor's Office has misinterpreted this exemption to apply to consultant contracts as well as to service contracts. Specifically, from November 1986 through January 1989, the Chancellor's Office improperly awarded at least 13 consultant contracts worth over \$940,000 to the foundation without obtaining the required competitive bids. Furthermore, this same exemption from competitive bidding on service contracts with the foundation allows the Chancellor's Office and other state agencies to legally avoid the State's competitive bidding requirements on service contracts and hire the contractors of their choice. Finally, based on the foundation's records, we estimate that the foundation generates significant profits from contracts with the Chancellor's Office and then uses those profits to fund activities for the Chancellor's Office that the Chancellor's Office could not legally fund itself.

THE CHANCELLOR'S OFFICE AWARDED
CONSULTANT CONTRACTS WITHOUT
THE REQUIRED COMPETITIVE BIDDING

Generally, the Chancellor's Office is required by state guidelines to obtain at least three competitive bids on its service and consultant contracts over \$1,000. Competitive bidding is required, in part, to ensure that the State is contracting with the most qualified contractors at the lowest possible cost. However, an amendment sponsored by the Chancellor's Office in 1986 to the Public Contract Code, Section 10340, exempts state agencies from obtaining three competitive bids on service contracts entered into with the foundation. Service contracts are defined as contracts for a specific mechanical skill such as maintaining office equipment. The Chancellor's Office, however, has misinterpreted this exemption to apply to its consultant contracts.

Consultant contracts are defined as contracts between the State and a private firm or individual that provides advisory or informational services. Such contracts call for a product of the mind, as distinguished from the rendering of mechanical skills. According to a Legislative Counsel's opinion, contracts between the foundation and state agencies that are, in whole or in part, for "consulting services" must be competitively bid unless specifically exempted by the Department of General Services.

From November 1986 through January 1989, the Chancellor's Office improperly awarded to the foundation 13 contracts totaling over \$940,000 for consulting services that were provided by either the foundation or other entities working for the foundation; however, the Chancellor's Office did not obtain competitive bids or an exemption from competitive bidding from the Department of General Services for these contracts. For example, one such contract for consulting services, worth over \$363,000, provided coordination, planning, and evaluation services for the Intersegmental Transfer Center Pilot Project. When the Chancellor's Office does not obtain competitive bids for its consultant contracts, the State cannot be sure that it has obtained the most qualified consultants at the lowest possible cost.

The Chancellor's Office's Use of the
Foundation's Exemption From Competitive
Bidding Circumvents the State's
Controls Over Contracting

The Chancellor's Office can use the foundation's competitive bidding exemption to circumvent the State's controls over competitive bidding. The Chancellor's Office primarily uses the foundation to serve as a master contractor. It enters into a contract with the foundation, which is not required to obtain competitive bids; the foundation then subcontracts with private contractors, who provide the actual service or expertise to the Chancellor's Office. Because the Chancellor's Office is exempt from competitive bidding on service contracts with the foundation, it circumvents the State's competitive

bidding requirements when it directs the foundation to hire the contractor of the Chancellor's Office's choice. For example, without obtaining competitive bids, the Chancellor's Office awarded the foundation three contracts that the Chancellor's Office considered to be service contracts, and according to the executive director of the foundation, the Chancellor's Office selected all five subcontractors hired under these contracts. Under this same exemption, other state agencies also can use the foundation as a master contractor and hire the contractors of their choice, thereby avoiding competitive bidding.

The California Community Colleges and the California State Universities have similar exemptions that allow them to enter into service contracts with their respective auxiliary organizations. These exemptions could allow the auxiliary organizations to operate service concessions such as campus bookstores and food services without obtaining competitive bids. However, the foundation, as a master contractor, does not operate such service concessions.

In addition, auxiliary organizations for the community colleges and state universities are governed by the Education Code while the foundation is governed by the Corporations Code for nonprofit, public-benefit corporations. The Education Code requires auxiliary organizations of the state universities to have their accounting procedures reviewed and approved by the Department of Finance. The Education Code further requires that auxiliary organizations of the community colleges have accounting procedures

comparable to those of the state university auxiliaries. Also, the superintendents of the community college districts and the presidents of the community colleges and state universities are held responsible for determining that all expenditures made by their auxiliary organizations conform with the policies and procedures established by their respective boards or trustees. Further, the superintendents and presidents are responsible for ensuring the propriety of the expenditures and the integrity of the financial reportings made by their auxiliary organizations. In contrast, the Corporations Code, governing nonprofit, public-benefit corporations such as the foundation, does not contain any provisions similar to those of the Education Code regarding fiscal accountability.

It may be desirable to have auxiliary organizations provide services such as campus bookstores and food services to their respective community colleges or state universities. However, since the State's competitive bidding requirements are designed, in part, to ensure that the State contracts with the best qualified contractor at the lowest possible cost, the State's best interests may not be served when the Chancellor's Office contracts through the foundation in a manner that allows it to effectively circumvent competitive bidding requirements.

The Foundation Profits From Contracts
With the Chancellor's Office

According to the foundation's articles of incorporation, its purpose is to further the educational goals and objectives of the Board of Governors and to benefit the community college system. While the foundation is allowed to make profits to accomplish this purpose, we estimate, based on the foundation's records, that it is generating significant profits from its contracts with the Chancellor's Office.

The Chancellor's Office is the administrative arm of the Board of Governors, with which the foundation has very close ties. The Board of Governors, which created the foundation in 1983, appoints the foundation's board of directors. Further, the foundation's current board has several people who have past relationships with the Chancellor's Office or the Board of Governors. For example, the foundation's interim board president is a former chancellor of the community colleges. Other current board members include former presidents of the Board of Governors and two current administrators from community college districts. Finally, the current chancellor of the community colleges and the current president of the Board of Governors are invited, in a non-voting, ex-officio capacity, to attend all meetings of the foundation's board of directors.

From October 1986 through December 1988, the foundation generated almost all of its revenues from contracts and grants with the

Chancellor's Office and other state agencies. For providing its service as master contractor, the foundation generally receives from state agencies between 5 to 15 percent of each total contract amount as an administrative fee. However, the foundation's costs of administering contracts with the Chancellor's Office have been significantly less than the administrative fees it has collected. For example, during this 27-month period, the foundation's records show that the foundation collected approximately \$71,600 in administrative fees exclusively from its contracts with the Chancellor's Office. We estimate that the foundation's actual costs of administering these contracts were only \$47,500. Consequently, we estimate that the foundation generated profits of approximately \$24,100 from its contracts with the Chancellor's Office.

Because of the close ties between the Chancellor's Office and the foundation, the Chancellor's Office can request the foundation to spend, on behalf of the Chancellor's Office, a portion of the profits the foundation generates through the administrative fees it receives from the Chancellor's Office.

Foundation Profits Are Used To
Fund Activities the Chancellor's
Office Itself Could Not Legally Fund

According to the foundation, its board of directors seeks advice from the Board of Governors in making expenditures on behalf of the Chancellor's Office and the Board of Governors. From October 1986

through December 1988, the foundation used some of its profits from contracts with the Chancellor's Office and other entities to make at least \$17,000 of expenditures on behalf of the Chancellor's Office and the Board of Governors. (The foundation's expenditures for this period are detailed in Appendix C.) While it is legal for the foundation to make such payments, \$9,200 of these expenditures were for items that the Chancellor's Office would be unable to legally purchase with its own funds. For example, approximately \$8,000 was used to pay for food, beverages, alcohol, and supplies used at receptions and meetings hosted by the Chancellor's Office and the Board of Governors. In addition, approximately \$1,200 was used to pay for the moving expenses of a former chancellor's executive assistant after the assistant left employment with the State. The Chancellor's Office would have had to submit claims to the State Controller's Office if the Chancellor's Office had used its own funds to pay these expenditures. According to the State Controller's Office, the Chancellor's Office does not have any legal authority to make such expenditures.

CONCLUSION

The Chancellor's Office of the California Community Colleges can use the Community College Foundation to circumvent the State's controls over contracting. In awarding at least \$940,000 of contracts for consulting services to the foundation without competitive bidding, the Chancellor's Office has misapplied the exemption from the State's

competitive bidding requirements on service contracts awarded to the foundation. In addition, the Chancellor's Office and other state agencies can use this same exemption to legally avoid the State's competitive bidding requirements on service contracts awarded to the foundation and can direct the foundation to hire the contractors of their choice. Finally, the foundation charges the Chancellor's Office and other state agencies an administrative fee for its services as a master contractor, some of which it then spends at the direction and on behalf of the Chancellor's Office. Because the purpose of the foundation is to assist the Chancellor's Office, it is not in the State's best interests for the foundation to make profits from its contracts with the Chancellor's Office and then use those profits for activities the Chancellor's Office itself could not legally fund.

RECOMMENDATIONS

To comply with state law, the Chancellor's Office of the California Community Colleges should discontinue awarding consultant contracts to the Community College Foundation without obtaining competitive bids or exemptions from competitive bidding from the Department of General Services.

The Legislature should reconsider the foundation's exemption from competitive bidding requirements for service contracts to determine if the exemption should apply when the foundation is acting primarily as a master contractor.

The Chancellor's Office should not pay the foundation administrative fees that exceed the actual cost of contract administration.

III

LOCAL ASSISTANCE FUNDS WERE USED TO PAY SOME ADMINISTRATIVE COSTS OF THE CHANCELLOR'S OFFICE

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office directed the expenditure of a portion of the \$7.3 million in local assistance funds appropriated for Disabled Student Programs and Services (DSPS) to pay administrative expenses normally paid from a state department's support budget. The expenditure of these funds is also discussed in Chapter I. These expenditures, made by its fiscal agents as instructed by the Chancellor's Office, were for such items as computer equipment, office rent, and travel expenses for staff of the Chancellor's Office. The Chancellor's Office can direct this use of DSPS local assistance funds because the budget act allows these funds to be used for "program accountability" and "program developmental services" but does not define or limit the activities that may be funded for these purposes. Furthermore, the budget act does not limit or specify the amount of DSPS local assistance funds that can be used for these purposes. From fiscal year 1983-84 through fiscal year 1987-88, the use of DSPS local assistance funds for "program accountability" and "program developmental services" has increased approximately 350 percent while local assistance funding for the entire DSPS program has increased only 29 percent.

LIMITS AND USES OF PROGRAM
ACCOUNTABILITY AND DEVELOPMENTAL
SERVICES ARE NOT CLEARLY DEFINED

The annual budget act appropriates funds to the Chancellor's Office to administer its programs (support funds) and to fund programs administered by community colleges (local assistance funds). According to the Legislative Counsel, the Chancellor's Office may not use local assistance funds to pay for the general clerical or administrative functions within the Chancellor's Office supporting that office or for statewide activities unless it has authority to do so. Such authority could come from the budget act, a provision of law, or the Department of Finance.

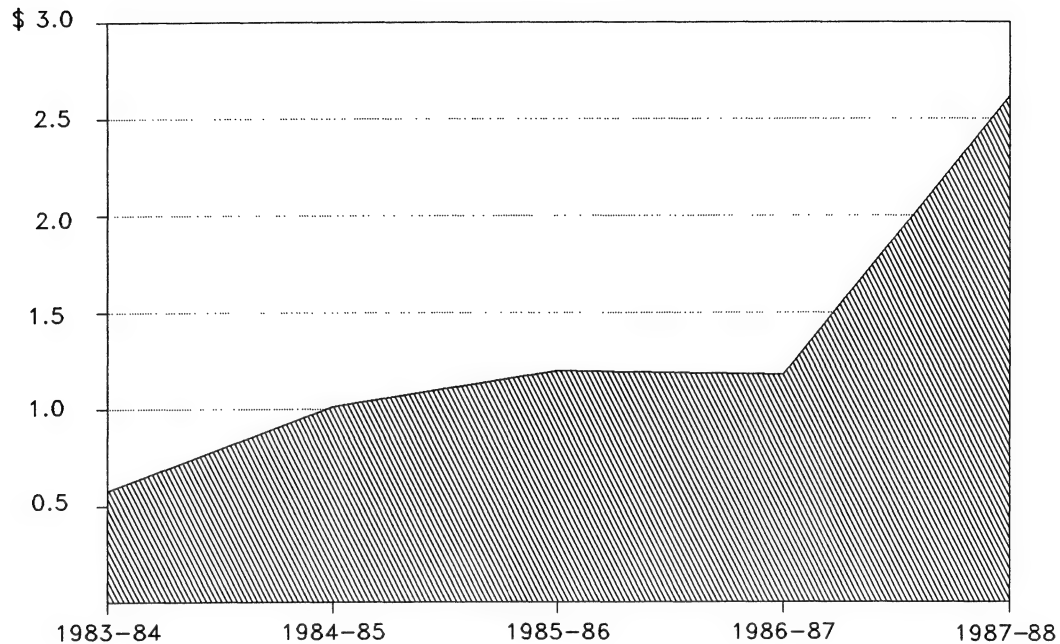
The 1987-88 Budget Act allocated an unspecified amount of the local assistance funds for Program Accountability and Developmental Services (PADS), an element within the DSPS. In reference to this allocation, the budget act says only that the funds appropriated for disabled students are for, among other things, "program accountability, [and] program developmental services for handicapped students enrolled at community colleges." The types of expenditures that may fall within this definition are not described. Furthermore, the budget act does not limit or specify the amount of DSPS local assistance funds the Chancellor's Office can allocate for PADS.

In contrast, similar allocations of local assistance funds in other programs provide limits or specify the amounts that can be used for certain activities. For example, the 1987-88 Budget Act specifies that the Board Financial Aid Program can use no more than \$200,000 of its local assistance funds for the administration of that program. In addition, the Education Code, Section 69648.5, allows the Chancellor's Office to use up to one percent of the Extended Opportunity Programs and Services local assistance funds to monitor and evaluate program activities.

Because the budget act does not limit the amount of funds that can be allocated for PADS, the Chancellor's Office determines that amount. In addition, because the budget act does not clearly define the use of PADS funds, the Chancellor's Office has been able to direct its fiscal agents to use these funds on behalf of the Chancellor's Office.

As discussed in Chapter I, the Chancellor's Office directed PADS funds to its fiscal agents at certain community college districts, which are outside the State's fiscal controls. From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office allocated at least \$6.5 million of DSPS local assistance funds to the fiscal agents' PADS accounts. As shown in Table 1, this allocation of DSPS funds for PADS has increased dramatically over the past five years. In fiscal year 1983-84, the Chancellor's Office allocated approximately \$580,000 of DSPS local assistance funds for PADS, as compared with over \$2.6 million allocated in fiscal year 1987-88.

TABLE 1
DSPS FUNDS ALLOCATED TO THE PADS ACCOUNTS
OF FIVE FISCAL AGENTS
FISCAL YEARS 1983-84 THROUGH 1987-88
(IN MILLIONS)



This is an increase of approximately 350 percent although the total local assistance funds appropriated to DSPS increased only 29 percent during this same period. Furthermore, of the \$2.1 million increase in DSPS local assistance funds from fiscal year 1986-87 to fiscal year 1987-88, approximately \$1.4 million (67 percent) was absorbed by PADS.

PADS Funds Were Used for
Administrative Costs

Generally, expenditures related to the administration of state programs are paid from a state department's support budget. However,

we found that many activities of the Chancellor's Office were funded with DSPS local assistance funds through PADS accounts. The PADS expenditures we reviewed included approximately \$466,000 spent to purchase and maintain a computer system used by various units of the Chancellor's Office, including the executive offices. In addition, the Chancellor's Office directed the expenditure of over \$278,000 of PADS local assistance funds to pay for a portion of its rent and over \$690,000 to pay for the travel expenses of various people, including Chancellor's Office employees. Finally, over \$1,170,000 of PADS funds was used to hire contract employees who worked within the Chancellor's Office.

The use of local assistance funds to hire contract employees for the Chancellor's Office has resulted in transactions that have been costly to the State. Specifically, in 1988, the Chancellor's Office asked the Community College Foundation to pay, on a temporary basis, five of the Chancellor's Office's contract employees. In return for this service, the foundation received an administrative fee of approximately \$3,670. In addition, because local assistance funds were used to pay these contract employees, the Chancellor's Office had to transfer the funds from one of its community college districts to the foundation. The community college district, acting as a fiscal agent, also received an administrative fee estimated at \$4,000 for making this transfer. In a letter to the foundation's executive director dated June 22, 1988, the vice chancellor of Student Services and Special Programs acknowledged that this arrangement was needed so that local

assistance funds could be used to pay the contract employees' salaries. Because the foundation and the college district both received administrative fees, the State paid approximately \$41,000 for contract employees' salaries costing approximately \$33,500.

CONCLUSION

During fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office increasingly directed its fiscal agents to use local assistance funds budgeted for Disabled Student Programs and Services for activities that are normally funded through a state department's support budget. The Chancellor's Office can use these funds for its administrative activities because the budget act does not limit the amount of DSPS local assistance funds that can be used by the Chancellor's Office for "program accountability [and] program developmental services," nor does it describe what those funds may be used for.

RECOMMENDATIONS

To ensure that the Chancellor's Office allocates local assistance funds as the Legislature intends, the Legislature should clarify the following:

- The amount or percentage of each program's funds, if any, it intends to be spent for the administration of the Chancellor's Office;
- The amount or percentage of each program's funds, if any, it intends to be spent for statewide projects under the direction and control of the Chancellor's Office;
- The amount or percentage, if any, it intends to be spent for statewide or regional projects under the direction and control of the community college districts; and
- The amount or percentage it intends to be spent for providing direct services at the community colleges under the control of the community colleges.

IV

THE CHANCELLOR'S OFFICE'S USE OF CONTRACT EMPLOYEES SOMETIMES CIRCUMVENTS THE STATE'S CIVIL SERVICE SYSTEM

The Chancellor's Office is circumventing the State's civil service laws by sometimes improperly contracting for services instead of hiring civil service employees. From September 1986 through December 1988, at least 88 contract employees worked at the Chancellor's Office. In some cases, these employees performed duties that would normally be performed by civil service employees. Moreover, for 48 of its 88 contract employees, the Chancellor's Office was unable to cite any hiring authority. The State Personnel Board reviewed two contracts concerning 7 of the 48 contract employees and concluded that the Chancellor's Office improperly entered into these contracts instead of hiring civil service employees. When the Chancellor's Office improperly contracts for services instead of hiring through the civil service system, individuals who have passed state civil service examinations are not given an opportunity to compete. Based on information provided by the Chancellor's Office, as of April 25, 1989, it had converted 20 of the positions formerly held by these 48 contract employees into civil service positions, while 8 of these employees were still working under contract for the Chancellor's Office.

THE CHANCELLOR'S OFFICE CONTRACTED
FOR SOME SERVICES IMPROPERLY

Under certain circumstances, individual state agencies are allowed to contract for personal services instead of hiring civil service employees. The California Government Code, Section 19130, specifies 11 of these conditions. For example, a state agency may contract for personal services when the services are of such an urgent, temporary, or occasional nature that the delay caused by the civil service hiring process would frustrate their purpose. In addition, state agencies may use personal service contracts when the services contracted for are not available within the civil service system.

Furthermore, the Education Code allows the Board of Governors to enter into exchange agreements with community colleges to hire instructors from the colleges, and the California Government Code allows for transfers of employees between jurisdictions.

Upon our request, the Chancellor's Office identified individuals who were not civil service employees but who worked for the Chancellor's Office at its headquarters at any time from September 1986 through December 1988. This included individuals who contracted through a fiscal agent, such as a community college district or the Community College Foundation, as well as individuals who worked for the Chancellor's Office without written contracts. We refer to this group of individuals as "contract employees."

No Hiring Authority Was Cited
For 48 Contract Employees

We asked the legal counsel of the Chancellor's Office to cite the authority that allowed the Chancellor's Office to hire contract employees instead of civil servants. The legal counsel cited various sections of the California Government Code and the Public Contract Code as authority to hire 40 of the 88 contract employees but was not able to cite authority for the remaining 48 contract employees. He stated that certain individuals or divisions within the office initiated contracts for these 48 contract employees without following the contracting process specified in its administrative manual. The administrative manual required staff of the Chancellor's Office to obtain the budget and accounting unit's approval for all contracts and the legal unit's approval, if necessary. In January 1987, the Chancellor's Office revised its contracting process to require that the legal unit review all contracts.

For the 48 contract employees for whom the Chancellor's Office was not able to cite authority, we reviewed duty statements, contracts, or other information provided by staff of the Chancellor's Office to determine whether there appeared to be authority to contract for services in lieu of hiring civil service employees. In addition, we reviewed State Personnel Board decisions regarding contract employees at the Chancellor's Office, whom the Chancellor's Office used to help administer many of its programs. Table 2 shows the programs in which these contract employees worked.

TABLE 2
PROGRAM FOR WHICH THE
48 CONTRACT EMPLOYEES WORKED

	<u>Number of Contract Employees</u>
Disabled Student Programs and Services	22
Extended Opportunity Programs and Services	8
Foster Care Education Programs	7
Greater Avenues For Independence; Cooperative Agencies Resources For Education	4
Board Financial Aid Program	3
Employment Training Unit	2
Intersegmental Transfer Center Pilot Project	<u>2</u>
Total	<u>48</u>

The State Personnel Board reviewed two contracts covering seven contract employees for whom the Chancellor's Office was not able to cite authority. It concluded that the circumstances under which the Chancellor's Office entered into these contracts did not satisfy the criteria for contracting for services rather than hiring civil service employees.

Four of these contract employees worked for either Extended Opportunity Programs and Services or the Intersegmental Transfer Center Pilot Project at the Chancellor's Office for between 25 and 33 months, performing duties normally performed by civil service employees. In

July 1988, all four positions were converted to civil service and are now funded from the Chancellor's Office's support budget.

Extended Opportunity Programs and Services also had six other contract employees whose contracts the State Personnel Board did not review. Four of these employees worked under contract for between 20 and 36 months. In addition, one contract employee stated that he was hired under the condition that he set himself up as a consulting firm, and place other contract employees on the consulting firm's payroll. Although some of these employees provided assistance to the consultant, others worked for Disabled Student Programs and Services on tasks that were unrelated to the contract's purpose. In fact, one of these employees was the secretary for the former acting dean of Special Services.

Also, we identified 14 contract employees who worked for Disabled Student Programs and Services at the Chancellor's Office without any form of written contract and were paid by a community college district, acting as a fiscal agent of the Chancellor's Office. According to the vice chancellor of Educational Policy, there were no written contracts between these contract employees and the Chancellor's Office or between these contract employees and the community college district. The vice chancellor also stated that the Chancellor's Office directed the community college district to pay these employees although the community college district did not have a contract with the Chancellor's Office to provide the services of these 14 employees.

Chapter I discusses the use of fiscal agents by the Chancellor's Office to channel money outside the State's fiscal controls.

Because the Chancellor's Office is circumventing the State's civil service laws by sometimes improperly contracting for services, individuals who have passed state civil service examinations are not given an opportunity to compete.

Based on information provided by the Chancellor's Office, as of April 25, 1989, it has converted 20 of the positions formerly held by the 48 contract employees to civil service positions. Twelve of these converted positions were filled by the contract employees referred to in Table 2. Of the 48 contract employees, 8 were still working under contract for the Chancellor's Office. However, determining the Chancellor's Office's compliance with civil service hiring practices from January 1, 1989, through April 25, 1989, was not within the scope of our audit.

Funding Was Not Often Requested for Additional Civil Service Positions

We reviewed the requests made by the Chancellor's Office for budget changes in fiscal years 1985-86 and 1986-87 to determine whether the Chancellor's Office tried to obtain funding for personnel through its support budget. For the seven programs listed in Table 2, the Chancellor's Office requested only six new positions during this period, yet as Table 2 shows, at least 48 contract employees worked for

these programs between September 1986 and December 1988. Thirty-three of these employees were paid with local assistance funds through fiscal agents of the Chancellor's Office because, without specific authority, the Chancellor's Office itself may not use local assistance funds to hire contract employees for general clerical or administrative functions within the Chancellor's Office. Chapter III discusses in detail the use of local assistance funds at the direction of the Chancellor's Office.

CONCLUSION

The Chancellor's Office is circumventing the State's civil service system by sometimes improperly contracting for services instead of hiring civil service employees. Of its 88 contract employees, the Chancellor's Office was not able to cite hiring authority for 48. The State Personnel Board reviewed two contracts covering 7 of these 48 employees and determined that the Chancellor's Office improperly entered into these contracts rather than hiring civil service employees. Furthermore, in most cases the Chancellor's Office did not try to obtain funding and authorization for civil service positions, but instead chose to use contracts to hire these 48 employees. As a result, the Chancellor's Office is not giving individuals who have passed state civil service examinations an opportunity to compete. As of April 25, 1989, the Chancellor's Office had converted 20 of the positions

formerly held by these 48 contract employees to civil service positions, while 8 of these employees were still working under contract for the Chancellor's Office.

RECOMMENDATIONS

To ensure that the Chancellor's Office does not circumvent the civil service system by improperly entering into contracts for services, the Chancellor's Office should take the following actions:

- Ensure that its legal counsel review all contracts for services currently in force, and determine whether such contracts meet the legal criteria for contracting for services;
- Request a determination by the State Personnel Board concerning the hiring authority cited for service contracts currently in force that its legal counsel has concluded are appropriate;
- Take appropriate action to terminate all contracts for services currently in force that its legal counsel or the State Personnel Board determines are improper; and

- Ensure that its legal counsel review all future contract proposals, as required by the contracts manual used by the Chancellor's Office.

V

EMPLOYEES OF THE CHANCELLOR'S OFFICE HAVE HAD TOO MUCH DISCRETION OVER ALLOCATING CERTAIN PROGRAM FUNDS

The employees of the Chancellor's Office who have been responsible for allocating funds to the community college districts for the Disabled Student Programs and Services program and other programs have had unilateral discretion over those allocations and have lacked proper supervision. For example, the former acting dean of the Special Services unit not only had responsibility for determining the total amount of Program Accountability and Development Services (PADS) funds available for expenditure on behalf of the Chancellor's Office, but he also had responsibility for determining which community college districts received those funds. In addition, the former acting dean of Special Services had discretion over the redistribution of unexpended funds from the DSPS program. During one fiscal year, the former acting dean redirected \$329,000 of these unexpended DSPS funds to supplement the amount available for PADS expenditures. As discussed in Chapter I, these expenditures that the Chancellor's Office instructed the fiscal agents to make were not subject to state fiscal controls. Further, other programs of the Chancellor's Office lack systematic methods for allocating funds to the community colleges, and some programs that have a systematic allocation method do not always follow their own procedures. As a result, the Chancellor's Office cannot ensure that the allocation process is objective and uniform. Finally,

we found weaknesses in the internal controls for other programs administered by the Chancellor's Office. The weaknesses in these programs are discussed in detail in Appendix D.

THE CHANCELLOR'S OFFICE LACKS A SYSTEMATIC
METHOD FOR ALLOCATING CERTAIN PROGRAM FUNDS

The Education Code, Section 78600(a), requires the Board of Governors to adopt rules and regulations for determining the allocation of funds to the districts for the education of handicapped students. In addition, the California Government Code, Section 13403(a)(6), states that the elements of a satisfactory system of internal control should include an effective system of internal review. However, the Chancellor's Office, as the administrative arm of the Board of Governors, does not have a systematic method for allocating certain program funds and does not have an effective system of internal review of those allocations to ensure adequate control over the programs it administers. Specifically, the employees of the Chancellor's Office who were responsible for determining the amounts allocated to the districts for PADS and other programs had unilateral discretion over how those funds were allocated, and their allocation decisions were not properly monitored.

From fiscal year 1983-84 through fiscal year 1987-88, the Chancellor's Office allocated at least \$6.5 million to five districts that acted as fiscal agents in disbursing funds on behalf of the Chancellor's Office. However, as discussed in Chapter I, the

expenditures made by these fiscal agents as instructed by the Chancellor's Office were not subject to the State's fiscal controls.

According to the vice chancellor of Educational Policy, the former acting dean of Special Services not only had responsibility for determining the total amount of PADS funds available for expenditure on behalf of the Chancellor's Office, but he also had responsibility for determining which community college districts received those funds. In addition, the former acting dean had responsibility for determining the recipients of any unexpended funds from the districts' DSPS programs. As a result, during fiscal year 1986-87, the former acting dean was able to redirect \$329,000 of unexpended funds from 18 community college programs to three districts, which acted as the Chancellor's Office's fiscal agents, making payments on behalf of the Chancellor's Office. This redirection moved these funds outside of the State's fiscal controls. For example, the former acting dean arbitrarily reduced one district's DSPS program funds by \$100,000 because the district did not report certain attendance figures, as required. He then used that amount to further supplement the PADS funds intended for expenditures on behalf of the Chancellor's Office.

We could find no evidence that the supervisor of the former acting dean of Special Services either formally reviewed or approved the allocation decisions or amounts sent to the districts. The former acting dean's supervisor stated that he informally reviewed and approved the former acting dean's allocation decisions and the amounts

sent to the districts. However, the supervisor could not provide us with any written evidence of such a review or approval.

In addition to the DSPS program, other programs of the Chancellor's Office lack systematic methods for allocating funds to the community colleges. For example, the unexpended EOPS funds allocated to the community colleges requesting funds is left to the discretion of the Extended Opportunity Programs and Services (EOPS) staff. The staff allocated over \$400,000 of unexpended EOPS funds to the community colleges during fiscal year 1987-88. Furthermore, those programs within the Chancellor's Office that have a systematic allocation method do not always follow their own procedures when allocating funds. The Fund for Instructional Improvement, Employer Based Training, and EOPS programs use committees to evaluate and recommend proposals from the community colleges for funding. However, we found instances in all three programs when the Chancellor's Office's evaluating committees did not follow their own procedures in scoring or recommending proposals for funding. We also found instances in the EOPS program when the Chancellor's Office funded proposals that were never evaluated by the committee as required. Furthermore, some of these proposals did not fall within the funding priorities that the committee and the Chancellor's Office had established. Because some programs within the Chancellor's Office lack a systematic method for allocating funds while others do not adhere to allocation methods that have been established, the Chancellor's Office cannot ensure that funds will be allocated in an objective and uniform manner.

CONCLUSION

Employees of the Chancellor's Office of the California Community Colleges who have been responsible for determining the amounts allocated to the community college districts for Program Accountability and Development Services and other programs have had unilateral discretion over those allocations and were not properly supervised. For example, during fiscal year 1986-87, the former acting dean of Student Services redirected \$329,000 from 18 college programs to three districts that acted as fiscal agents to fund expenditures on behalf of the Chancellor's Office. Additional programs within the Chancellor's Office also lack systematic methods of allocating funds or do not use their own allocation procedures. Consequently, the Chancellor's Office cannot ensure that funds will be allocated in an objective and uniform manner.

RECOMMENDATIONS

The Chancellor's Office should take the following actions to ensure that the funds for the programs it administers are properly allocated to the districts:

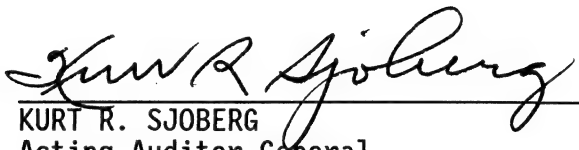
- Establish a written, systematic method for allocating funds used on behalf of the Chancellor's Office. If the

Legislature does not limit the amount available for expenditure on behalf of the Chancellor's Office, the Chancellor's Office should limit this amount to a set percentage of the total funds appropriated for each program;

- Establish a written, systematic method for the redistribution of unexpended funds from the districts' college programs;
- Require written administrative approval of all amounts sent to the districts; and
- Require that an administrator monitor the systematic methods established above, and make certain that the Chancellor's Office adhere to its procedures for allocations and that it not exceed funding limits for expenditures made on behalf of the Chancellor's Office.

We conducted this review under the authority vested in the auditor general by Section 10500 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,


KURT R. SJOBERG
Acting Auditor General

Date: May 8, 1989

Staff: Philip Jelichich, CPA, Audit Manager
Doug Cordiner
Gregory J. Brown, CPA
Fred S.C. Forrer, CPA
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James M. Heggli, CPA
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Reed M. McDermott, CPA
Jeffery J. Stevens, CPA
Mark T. Wallace, CPA
Cynthia L. Traxler
Peggy Folmar
Arn Gittleman

APPENDIX A

**NAMES AND TERMS OF CHANCELLORS
OF THE CALIFORNIA COMMUNITY COLLEGES**

<u>Chancellor's Name</u>	<u>Employment Term</u>
Gerald Hayward Permanent Full Time	January 1, 1980 through August 29, 1985
Joshua L. Smith Permanent Full Time	August 30, 1985 through September 30, 1987
John Randall (Interim)	October 1, 1987 through June 30, 1988
David Mertes Permanent Full Time	July 1, 1988 to Present

APPENDIX B

**SCHEDULE OF FISCAL AGENT PAYMENTS
BY TYPE OF EXPENDITURE
FISCAL YEARS 1983-84 THROUGH 1987-88**

<u>Type of Expenditure</u>	<u>Fiscal Agent Payments Benefiting the Chancellor's Office</u>	<u>Percentage of Total Fiscal Agent Expenditures by Category</u>
Certificated salaries	\$ 302,498	3.33%
Classified salaries	36,949	0.41
Employee benefits	58,272	0.64
Supplies	214,492	2.36
Consulting services	5,037,861	55.49
Travel	1,113,339	12.26
Activities	155,296	1.71
Rents	280,980	3.09
Equipment	755,855	8.32
Other expenditures	424,493	4.67
Administrative fees	<u>701,518</u>	<u>7.72</u>
Total Expenditures	<u>\$9,081,553</u>	<u>100.00%</u>

Source: The dollar amounts in this table are from the five districts' expenditure reports for Disabled Student Programs and Services, Extended Opportunity Programs and Services, and Cooperative Agencies Resources for Education.

Note: These expenditures were made by five community college districts: Los Rios Community College District, North Orange County Community College District, San Diego Community College District, Yosemite Community College District, and Foothill-De Anza Community College District.

EXPENDITURES OF THE COMMUNITY COLLEGE FOUNDATION
OCTOBER 1, 1986 THROUGH DECEMBER 31, 1988

<u>Contract Source Description</u>	<u>Salaries</u>	<u>Benefits</u>	<u>Travel</u>	<u>Equipment</u>	<u>Rent</u>	<u>Supplies</u>	<u>Consulting</u>	<u>Other</u>	<u>Total</u>
Department of Rehabilitation	\$2,567,939	\$285,088	\$131,928	\$1,435,410	\$47,395	\$21,763	\$ 12,568	\$ 371,024	\$4,873,115
Department of Transportation	768,401	0	0	0	0	0	0	32,896	801,297
Chancellor's Office	317,834	22,566	8,543	217	8,700	2,802	208,546	56,380	625,588
Department of Social Services	0	0	(658)	0	0	0	175,947	677,645	852,934
Los Angeles County	253,335	24,250	2,467	13,648	0	174	3,700	301,024	598,598
California Occupational Information Coordinating Committee	0	0	1,017	0	0	0	24,282	0	25,299
Los Rios Community College District	29,974	4,063	0	0	0	0	0	2,665	36,702
Administrative Expenses	32,900	5,439	30,654	8,336	4,452	5,887	3,002	77,097	167,767 ^a
Expenditures Made on Behalf of the Board of Governors	0	0	1,868	0	0	0	0	0	1,868 ^b
Total	<u>\$3,970,383</u>	<u>\$341,406</u>	<u>\$175,819</u>	<u>\$1,457,611</u>	<u>\$60,547</u>	<u>\$30,626</u>	<u>\$428,045</u>	<u>\$1,518,731</u>	<u>\$7,983,168</u>

Source: The figures are based on the records of the Community College Foundation.

^a Approximately \$426,000 of the Community College Foundation's administrative expenses were paid with grant funds from the Department of Rehabilitation. These expenses are included in the expenditures for the Department of Rehabilitation.

^b The Community College Foundation expended approximately \$17,000 on behalf of the Board of Governors and Chancellor's Office. The balance of the expenditures are reflected in the administrative expenses line.



APPENDIX D

Telephone:
(916) 445-0255

STATE OF CALIFORNIA
Office of the Auditor General

660 J STREET, SUITE 300
SACRAMENTO, CA 95814

Kurt R. Sjoberg
Acting Auditor General

April 27, 1989

Management Letter P-768

Scott F. Wylie
President of the Board of Governors
California Community Colleges
1107 Ninth Street, Suite 600
Sacramento, California 95814

Dear Mr. Wylie:

As part of our audit report entitled "The Chancellor's Office of the California Community Colleges Has Developed Procedures That Result in a Circumvention of Many State Fiscal Controls," we assessed the internal controls of the Chancellor's Office of the California Community Colleges (Chancellor's Office) for disbursing funds for various programs. In addition to the topics discussed in our audit report, other matters came to our attention that we believe require corrective action by the administrators of the Chancellor's Office. Those matters are discussed in detail in this letter.

On April 24, 1989, my staff met with David Mertes, Doug Burris, Joe Newmyer, and other staff members of the Chancellor's Office to discuss weaknesses in the Chancellor's Office's internal controls for disbursing program funds. During the meeting, we suggested solutions to the problems in internal control. The following is a summary of the items discussed during the meeting.

**DEFICIENCIES IN THE CHANCELLOR'S OFFICE'S
CONTRACTING PROCEDURES**

Item 1.

**The Chancellor's Office Allowed Activities To Begin
Before Contracts Were Approved**

Finding:

During our testing of contracts with the Community College Foundation (foundation), we identified five instances in which the Chancellor's Office allowed contract-related activities to begin before contracts were approved by the appropriate authority. (For more information on the contracting relationship between the Chancellor's Office and the

Scott F. Wylie
President of the Board of Governors
April 27, 1989
Page 2

foundation, please refer to Chapter II of the attached audit report.) Consequently, costs totaling over \$40,000 were incurred before approval of the contracts.

In one instance, the foundation, acting as fiscal agent for the Chancellor's Office, incurred costs totaling \$24,429 (70 percent of the total contract amount) during the three months before the Department of General Services approved the contract. In another instance, the Chancellor's Office incurred \$10,884 in travel expenses related to its Immigration Reform Control Act (IRCA) program for up to one year before the Department of General Services approved the foundation's IRCA contract. The foundation refused to pay for costs incurred before the contract had been approved.

By allowing costs to be incurred before valid contracts were in place, the Chancellor's Office exposed the State to potential litigation.

Criteria:

The State Administrative Manual, Section 1204, requires that, except in emergency cases to protect human life or state property, agencies must submit each contract for services in time for the Department of General Services to approve it before the commencement of work.

The Public Contract Code, Section 10371, states that, except in an emergency, performance under a consultant contract shall not commence before DGS approval or, if DGS approval is not required, before approval by an authorized officer of the contracting agency.

Recommendation:

The Chancellor's Office should not begin contract-related activities until the proper authority approves the contract.

Item 2. The Chancellor's Office Did Not Consistently
Withhold 10 Percent From Progress Payments Issued
Under Consultant Contracts

Finding: The Chancellor's Office did not withhold the required 10 percent from some progress payments issued under three of its consulting services contracts with the foundation.

Specifically, the Chancellor's Office did not withhold 10 percent from 7 of 21 progress payments issued for a \$363,000 contract relating to its Intersegmental Transfer Center Pilot Project. Under the two other contracts, the Chancellor's Office did not withhold the required 10 percent from any progress payments issued. For example, it did not withhold the required 10 percent for a \$95,000 consultant contract for the Greater Avenues for Independence program.

By failing to withhold the required 10 percent from progress payments pending satisfactory performance of all contract terms, the Chancellor's Office cannot ensure that it receives services in accordance with the contract.

Criteria: The Public Contract Code, Section 10379, states that consultant contracts may provide progress payments to contractors for work performed or costs incurred in the performance of the contract, provided that not less than 10 percent of the contract amount is withheld pending final completion of the contract and an evaluation of the contractor's performance.

The State Administrative Manual, Section 1244, states that in computing the amount of any progress payment, the state agency should determine what the contractor has earned during the period for which payment is being made on the basis of the contract terms but retain out of such earnings an amount at least equal to 10 percent.

Scott F. Wylie
President of the Board of Governors
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Recommendation: The Chancellor's Office should withhold 10 percent of any progress payments issued under consulting services contracts.

Further, contracting and legal personnel within the Chancellor's Office should ensure that all consulting services contracts that provide for progress payments also contain language that provides for a 10 percent withholding from those payments pending satisfactory completion of all contract terms and an evaluation of the contractor's performance.

Item 3. The Chancellor's Office Did Not Always Adequately Monitor Its Contracts With the Foundation

Finding: During our testing of contracts with the foundation, we identified deficiencies with the Chancellor's Office's system for monitoring contracts. For example, the designated project monitor of a Foster Parent Training contract, the former acting dean of Student Services, knew that the terms of the contract had not been fully performed; however, he approved a final claim for \$31,650, the balance of the contract amount. Included in the payment was \$17,500 for services never performed under that agreement but later performed, with the foundation again being compensated, under a different contract. Thus, because of improper monitoring of the first contract, the Chancellor's Office paid the foundation twice for the same services. On April 11, 1989, the foundation returned \$18,617 to the Chancellor's Office, representing funds unspent under the original Foster Parent Training contract.

Criteria: The administrative manual of the Chancellor's Office states that the contract monitor is responsible for overseeing the project as a whole. According to the manual, this oversight would include responsibility for approving invoices for payment and ensuring that the Chancellor's Office has received the services for which it has been billed.

The State Administrative Manual, Section 8422.1, requires state agencies to ensure that items that have been billed have been received and that invoices comply with the terms of the related contracts.

Recommendation: The Chancellor's Office should adopt procedures to ensure that all contracts are properly monitored. Specifically, it should ensure that project monitors only approve payments for services that have been received and that comply with the contract terms.

DEFICIENCIES WITH THE ALLOCATION PROCESS OF THE CHANCELLOR'S OFFICE

Item 1.

The Chancellor's Office Lacks Written Policies and Procedures for Some of Its Programs

Finding: The Chancellor's Office does not have documented policies and procedures describing the methods to be used for allocating funds to its programs. We observed the following deficiencies:

- During fiscal year 1987-88, the Chancellor's Office allocated over \$3 million to community college districts providing educational services to residents of state hospitals. In addition, it allocated over \$897,000 to districts providing training to foster parents. However, the Chancellor's Office had not established written policies and procedures describing the methods to be used for computing the initial allocation of funds for its Residents of State Hospitals and Foster Parent Training programs;
- The Chancellor's Office had not established specific policies and procedures describing the methods to be used for adjusting allocations for the following student services programs: Matriculation, Intersegmental Transfer Center Pilot Project, Cooperative Agencies Resources for Education, and the local administration funds for the Board Financial Aid Program; and

Scott F. Wylie
President of the Board of Governors
April 27, 1989
Page 6

- For the Residents of State Hospitals program, the Chancellor's Office had not established written policies and procedures governing the expenditure of program funds, the disposition of unspent funds, the documentation and reporting of program and administrative functions, and the monitoring of individual state hospital programs. By failing to establish such controls, the Chancellor's Office cannot ensure that state funds are appropriately spent and adequately protected.

By failing to establish written policies and procedures describing the methods to be used to compute the initial allocation of some program funds or later adjustments to those allocations, the Chancellor's Office cannot ensure that the allocation process is uniform and objective.

Criteria:

The California Education Code, Section 78600(a), requires the Board of Governors of the California Community Colleges to adopt rules and regulations for determining program and service components and appropriations of resources to individual community college districts for the education of handicapped students.

Further, the California Government Code, Sections 13402 and 13403, requires state agencies to establish and maintain an adequate system of internal administrative and accounting control. Such a system should include authorization and recordkeeping procedures, an established system of practices to be followed in performance of duties and functions, and an effective system of internal review.

Recommendation:

The Chancellor's Office should adopt policies and procedures directing the methods to be used for computing the initial allocation of program funds for the Foster Parent Training programs. In addition, it should adopt policies and procedures directing the methods to be used for computing

subsequent adjustments to allocations of funds for Matriculation, Intersegmental Transfer Center Pilot Program, Cooperative Agencies Resources for Education, and local administration funds for the Board Financial Aid Program.

Further, for the Residents of State Hospitals program, the Chancellor's Office should adopt policies and procedures pertaining to all administrative components including the allocation of program funds, the expenditure of program funds, the disposition of unspent funds, adequate documentation and reporting of program and administrative functions, and the monitoring of individual state hospital programs.

Item 2.

The Chancellor's Office Did Not Comply With Its Own Procedures When Allocating Some Program Funds

Finding:

The Chancellor's Office did not comply with its own procedures for allocating funds for two of its programs. The Chancellor's Office relies on its advisory committees (committees) to review funding proposals for the Fund for Instructional Improvement (FII) and Employer Based Training (EBT) programs. These committees recommend which proposals should be funded and the amount of the funding. The proposal forms used by the community college districts to request such funding were developed by the Chancellor's Office, and based on our examination of the proposal forms, we determined that recommendations were to be based on scoring criteria. However, we identified one instance in fiscal year 1987-88 in which the committee that recommends FII funding did not base its recommendations solely on the scoring criteria in the proposal forms. In addition, the Chancellor's Office did not follow its own procedures and use a consistent method of scoring for its EBT proposals for fiscal year 1987-88. For 6 (7 percent) of 83 proposals, the Chancellor's Office dropped the lowest of three rating scores when averaging district scores while, for the remaining 77

proposals, it did not drop the lowest of three rating scores. During fiscal year 1987-88, the Chancellor's Office allocated over \$4.5 million for these programs.

By failing to comply with established selection procedures for allocating program funds, the Chancellor's Office cannot ensure that the funding process is uniform and objective.

Criteria: The proposal forms used by the districts to request FII funding were developed by the Chancellor's Office. The forms indicate that selection will be made using the criteria indicated on the forms.

According to the dean of the EBT program, the average of three rating scores should be used in determining the allocation of EBT funds.

Recommendation: The Chancellor's Office should follow established procedures pertaining to the selection of proposals for FII and EBT program funds to ensure that the selection process is uniform and objective.

Item 3. **The Chancellor's Office Did Not Reconcile Its Records of Individual Program Allocations With Records Maintained by the State Controller's Office**

Finding: The Chancellor's Office did not reconcile its records of the allocations made to individual programs within the Disabled Student Programs and Services (DSPS) unit for fiscal year 1986-87 with records maintained by the State Controller's Office.

Funds appropriated for DSPS are allocated among three programs: Disabled Student Allowance, Residents of State Hospitals, and Workability II. However, the Chancellor's Office did not reconcile its records of the allocations at the program level. As a result, it could not identify which program received \$26,000 of the DSPS funds.

Criteria: The State Administrative Manual, Section 7900, requires state agencies to reconcile their records with the records maintained by the State Controller's Office. Although Section 7900 does not specifically require agencies to reconcile records at the lowest program level, the Chancellor's Office should reconcile at this level to meet the intent of the section. The section states that the intention of reconciling is to promote the disclosure of any errors in the agency accounts.

Recommendation: The Chancellor's Office should reconcile its records of allocations at the lowest program level with records maintained by the State Controller's Office.

OTHER INTERNAL CONTROL WEAKNESSES

Item 1. The Chancellor's Office Did Not Have Adequate Control Over Cash Receipts

Finding: The Chancellor's Office did not deposit over \$9,000 that it received more than one year ago from the sale of handbooks.

Between April 1, 1987, and March 31, 1988, the former acting dean of Special Services received checks totaling over \$9,000 from the sale of handbooks developed for the DSPS unit. Each of the checks was made payable to one community college district, which acted as a fiscal agent for the Chancellor's Office. Because the checks were made payable to the district, they would have been deposited outside of the state treasury system and outside of the State's fiscal controls.

When the former acting dean tried to deposit the checks with the fiscal agent, the fiscal agent refused to accept them. Because the checks are not payable to the Chancellor's Office, the Chancellor's Office cannot deposit them into the centralized state treasury system. Consequently, the checks remain undeposited, resulting in a potential loss of more than \$9,000.


Scott F. Wylie
President of the Board of Governors
April 27, 1989
Page 10

Criteria: The State Administrative Manual, Section 8001, requires that all money controlled by a state agency be deposited into the centralized state treasury system, unless authorized by the director of Finance.

Recommendation: The Chancellor's Office should contact buyers of the handbook and request that the buyers issue new checks payable to the Chancellor's Office. Moreover, the Chancellor's Office should then deposit all receipts in the centralized state treasury system, according to the procedures described in the State Administrative Manual.

If you have a different perception of any of the items summarized above, please let me know by May 4, 1989. Thank you for your cooperation.

Sincerely,


KURT R. SJOBERG
Acting Auditor General

cc: David Mertes, Chancellor
California Community Colleges

CALIFORNIA COMMUNITY COLLEGES

1107 NINTH STREET
SACRAMENTO, CALIFORNIA 95814
(916) 445-8752



May 4, 1989

Mr. Kurt R. Sjoberg
Acting Auditor General
Office of the Auditor General
660 J Street
Sacramento, CA 95814

Dear Mr. Sjoberg:

The discovery of an alleged embezzlement in the State Community College Chancellor's Office in August 1988 triggered a criminal investigation and the arrest of an employee the following month. In September, I requested both an extension of that investigation by the Department of Justice and a comprehensive fiscal and management audit by the Auditor General's Office. My purpose was to determine if further criminal activity existed, as well as to analyze the processes that led to the existence of an alleged embezzlement that went undetected for years.

I am satisfied that the audit findings are confined primarily to specific lapses in management and fiscal processes that allowed the alleged embezzlement to occur.

At the time I discovered the alleged embezzlement, members of your office were - at the request of the Legislative Audit Committee - involved in reviewing contracts processed through the Community College Foundation. I have initially reviewed the results of that inquiry, which are also included in your report. We will continue to examine the specific details in the coming weeks.

I am reassured to find that the predominance of the audit findings relate directly to the individual who was arrested and to procedures that individual monitored or established. (1) It should be noted that the materials and activities scrutinized by the audit team primarily cover fiscal years 1986 through 1988. (2) Since the discovery of the alleged embezzlement by this office, and working with your staff, I have initiated changes in several management procedures which reflect a number of the recommendations in your report.

It is clear that over time, and with the State encouraging the use of contracts, the proper use of contracts by this office became questionable. Contract procedures already have been tightened substantially, and further corrective actions are being taken.

The procedures and criteria for allocating local assistance funds in the two major categorical programs have been revised thoroughly, and the proposed changes will be reviewed by the Board of Governors at the May 11 and 12 meeting. Additionally, procedures will be adopted for the careful reconciliation of the Chancellor's Office records with the State Controller's Office.

Two areas that are receiving further review by my office are: the relationship between the Chancellor's Office and districts that serve as fiscal agents; and the relationship of the Chancellor's Office and The Community College Foundation. The audit appears to confirm that nothing illegal has transpired. ³ In both instances cited, the activities are tied primarily and directly to the individual involved with the alleged embezzlement, and the audit notes that insufficient checks and balances led to the conditions in which the alleged illegal activities could take place.

These relationships are being thoroughly analyzed and evaluated. Also under careful review is the relationship of the California Community Colleges and The Community College Foundation. Again, the audit raises no charge of illegality in fiscal procedures, but questions the propriety of certain aspects of the relationship.

Recommendations of the audit report which, I am glad to report to you, have already been addressed by the Chancellor's Office include:

- * The Vice Chancellor of Legal Affairs reviews all contracts.
- * The Vice Chancellor for Fiscal Policy signs off on all contract payments.
- * The Chancellor's Office is requiring the Foundation to establish appropriate processes for selecting subcontractors.
- * Revised allocation procedures for the two cited categorical programs are pending approval by the Board of Governors.
- * Procedures for the distribution of any excess or unexpended funds have been revised and are also pending final approval.
- * The number of contract employees cited in the audit as inappropriate has been dramatically reduced over the past few months.

My office fully understands that there are shortcomings in certain processes; these can and will be improved. Supervision and management processes are being solidified. The audit report provides a sound basis on which to assess the future efficiency and fiscal processes of the Chancellor's Office.

May 4, 1989

My staff and I appreciate the thoroughness and intensity with which your office conducted its investigation relative to the activities surrounding the alleged embezzlement. The audit explicitly notes that the criminal acts occurring within the Chancellor's Office were clearly isolated to a single individual and the processes and procedures which allowed such activities were, for the most part, adopted at the direction of that individual without adequate management supervision.

Outside of those activities, your findings indicate that - except in limited and specific instances - this office is essentially working effectively and efficiently in handling more than \$2 billion in allocations to 107 colleges which serve more than 1.3 million students throughout the state (4)

I wish to reiterate my concern about possible misinterpretation of some of the report's findings. Certain chapter titles and the general tone of the report suggest that the findings reflect on the entire agency, when in fact they refer only to the management and supervision of specific and isolated situations. (5)

On behalf of the members of the Board of Governors and the Chancellor's Office, I am undertaking a careful analysis of all the specific audit recommendations and will present further comments to you within 60 days.

Sincerely,

David Mertes
DAVID MERTES
Chancellor

DM:ar

cc: Board of Governors

**THE OFFICE OF THE AUDITOR GENERAL'S COMMENTS
ON THE RESPONSE BY THE CHANCELLOR'S OFFICE
OF THE CALIFORNIA COMMUNITY COLLEGES**

We are commenting on the Chancellor's Office's response to our audit report to provide clarity and perspective to the response to our report. The numbers correspond to numbers we have placed in the Chancellor's Office's response.

- ① The majority of our audit findings specifically relate to the failure of the Chancellor's Office to establish and maintain an adequate system of internal control. Although we illustrate the effect of the deficiencies by referring to an alleged embezzlement by a single individual, the opportunity for abuse continues to exist as long as the Chancellor's Office fails to establish and maintain an adequate system of internal control.

As provided in the California Government Code, the responsibility for establishing and maintaining an adequate system of internal control ultimately rests with the agency head.

- ② As we explained on page 6 of our report, our testing primarily covered fiscal year 1983-84 through fiscal year 1987-88.
- ③ As we explained on page 11 of our report, the use of fiscal agents by the Chancellor's Office circumvents state fiscal controls. This circumvention provided the opportunity for an individual to allegedly embezzle state funds. Thus, we did not conclude that "nothing illegal has transpired" from the use of fiscal agents.
- ④ The scope of our audit did not include an overall evaluation of the effectiveness or efficiency of the Chancellor's Office. Consequently, we did not make any conclusions as to the effectiveness or efficiency of the Chancellor's Office's statewide allocation in our report.
- ⑤ As explained in our report, our testing identified deficiencies in ten different programs administered by various employees of the Chancellor's Office and, therefore, did not involve "isolated situations."

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps